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031103Z Jul 03

UNCLAS SECTION 01 OF 02 COLOMBO 001161

SIPDIS

DEPT PLEASE PASS TO USTR
TREASURY FOR GRAO
DOC FOR ITA: ABENAISSA, LDROKER

E.O. 12958: N/A

TAGS: [ECON](#) [EINV](#) [ETRD](#) [CE](#) [ECONOMICS](#)

SUBJECT: FTA'S DOMINATE SRI LANKA'S TRADE POLICY

Refs: (A) Colombo 1146, (B) Colombo 772

1. Summary: The Government of Sri Lanka (GSL) is in the process of developing a coherent trade policy, focused on increasing market access for Sri Lankan goods through free trade agreements. Two US Representatives who recently were in Sri Lanka on a private visit sponsored by a local business chamber (to be reported septel) heard much about GSL's ambitious plans for negotiating FTAs. Aiming to create economic growth and ease the adjustment to the post-Multi-Fiber Agreement (MFA) world, the GSL wants Sri Lanka to become the region's trading hub, connected through a series of bilateral arrangements. Sri Lanka is now deepening economic ties with India under a comprehensive economic partnership and is looking in other directions, especially toward the US. End Summary.

Sri Lanka aims for 30 FTAs...

2. On June 26, in an interview with "Daily News," Sri Lanka's Commerce Minister said he wanted to sign over 30 FTAs, with countries primarily in SE Asia and the Middle East. These agreements are intended to help combat the negative impact of the termination of the MFA, which favors Sri Lanka by limiting external competition to its all-important apparel exports. Heavily dependent on exports, Sri Lankans are worried by the free trade arrangements and concessions which allow other low-income countries quota- and tariff-free access to some developed markets, especially the EU.

3. The GSL hopes to utilize FTAs and the country's strategic location to become a regional hub for trade, manufacturing and transport. Emphasizing Sri Lanka's advantages to British investors in London last week, Prime Minister Ranil Wickremesinghe referred to trade liberalization as one of the key pillars of his government's economic reforms program. He said that Sri Lanka's goal is to reduce barriers and maximize access to key markets throughout the region and the world. He also reiterated the Government's interest in pursuing multiple free trade agreements.

4. INDO-LANKA FTA: Sri Lanka's first free trade arrangement, the Indo-Lanka Free Trade Agreement (ILFTA), covering only goods, has been in operation since March 2000. Although the agreement has doubled two-way trade between India and Sri Lanka to almost \$1 billion, it is far from a perfect FTA, being flawed by large negative lists on each side (see ref B for a fuller assessment of the agreement). Planning to expand the ILFTA, the Prime Ministers of the two countries met in March, and agreed in principle to enter into an Economic Partnership Agreement (EPA). Currently, an Indo-Lanka Study group is exploring areas of cooperation including trade in services, investment, IPR protection, electronic trade, trade facilitation, and movement of persons in order to formulate a framework agreement.

5. OTHER FTAS: In addition to the ILFTA, talks are getting underway for FTAs with Pakistan and Egypt. (The Egyptian Ambassador told us the last trade talks with Sri Lanka had taken place six years ago but said the current Commerce Minister was eager to get a new round started.) Pakistan and Sri Lanka have already signed a framework agreement, but conclusion of the final agreement has been delayed due to disagreement over access of agricultural commodities. Sri Lanka also plans to discuss an FTA with Bangladesh. Working regionally, Sri Lanka actively participates with Bangladesh, India, Myanmar, and Thailand (together, the so-called

BIMST grouping) in an effort to create a free trade agreement among BIMST-Economic Commission countries. In June, the group held negotiations in Colombo on a draft framework agreement for a BIMST area-FTA. This agreement is expected to be signed at the next meeting of BIMST heads of state in February 2004. According to sources at the Sri Lankan Department of Commerce (DOC), most of the other FTAs are still in conceptual stage.

...as SAARC trade liberalization stalls

16. These attempts to open markets through other trade agreements, especially the ILFTA, show the lack of progress on a South Asia Free Trade Agreement (SAFTA) mooted by South Asian Association for Regional Cooperation (SAARC). For the past several years, the South Asian nations have been formulating a framework agreement for a SAFTA, originally planned to come into effect by 2005. According to DOC sources, SAARC officials will meet in Nepal later in July in a bid to finalize a framework agreement.

17. Meanwhile, the success of South Asian Preferential Trade Arrangement (SAPTA), the precursor to SAFTA, which came into force in December 1995, has also been limited. After three rounds of negotiations, SAPTA covers only about 10% of tariff lines. This is perhaps because no country has seriously considered promoting intra-regional trade by including most traded commodities under the agreement. The exchange of tariff concessions under SAPTA came to a standstill from 1998-2001, due to political problems between India and Pakistan, two key members of SAARC. The fourth round of SAPTA talks was held in December 2001 but member countries are yet to exchange tariff concessions agreed at this round.

But a US FTA would set a new standard

18. While pursuing new markets through free trade arrangements, the GSL is anxious to move forward with the US Trade and Investment Framework Agreement (TIFA) process and on to a comprehensive FTA. From the GSL point of view, a FTA with US is vitally important to stay competitive in its largest export market. Unlike its other regional and bi-lateral agreements, however, the higher standards and more comprehensive nature of a US FTA will require that Sri Lanka overhaul its regulatory regime and practices. As described in ref A, Sri Lanka is beginning to understand just how high US standards are for FTAs, as it studies the Singapore and Chile texts as possible models.

Comment

19. Given this nation's dependence on trade, as well as its ongoing reform agenda, relatively open market and small size, Sri Lanka appears to be the South Asian nation best suited to become a free trade hub. While GSL may intellectually understand the level of liberalization required under a US FTA, it will need to prove it has the capacity and political will to carry out the necessary reforms. In particular, the government will need to lower tariffs and further open the agriculture and services markets, as well as improve intellectual property protection, transparency and the regulatory regime. An FTA with the US would also establish new standards for the labor and environment sectors. Meanwhile, Sri Lanka's efforts to conclude more limited agreements continue.

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